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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-526

SECURITIES INVESTOR PROTECTION CORPORATION,

*Cross-Petitioner,*

*against*

TOUCHE ROSS & Co.,

*and*

EDWARD S. REDINGTON, as Trustee for the Liquidation of the Business of WEIS SECURITIES, INC.,

*Respondents.*

## CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI OF SECURITIES INVESTOR PROTECTION CORPORATION

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### Preliminary Statement

Securities Investor Protection Corporation ("SIPC") requests that, in the event this Court should grant the petition for a writ of certiorari made by Touche Ross & Co. ("Touche Ross") in No. 78-309, this Court should also grant a writ of certiorari to the United States Court of Appeals for the Second Circuit to review the question of whether SIPC may maintain *on its own behalf* a right of

action under Section 17(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78q(a).*

## Opinions Below

In an opinion written by Judge Lumbard, the Court of Appeals held (1) that customers of a defunct brokerage firm have a right of action under Section 17(a) of the 1934 Act against an accounting firm which breaches its duty under that Section, and (2) that SIPC may assert that right of action as the subrogee of such customers. Judge Timbers wrote an opinion in which he expressly concurred "without qualification" in Judge Lumbard's majority opinion. Judge Mulligan wrote a dissenting opinion disagreeing with the majority's holdings. It is with respect to these holdings that Touche Ross has made its petition for certiorari in No. 78-309, the granting of which is vigorously opposed by SIPC.

However, the Court of Appeals majority, having held that SIPC may maintain a Section 17(a) action as the subrogee of the customers of Weis Securities, Inc. ("Weis"), stated in a footnote that it "need not reach the question [of] whether SIPC could ever have a claim for damages other than on behalf of a broker's customers" (12a, n.13.** Yet, in that same footnote the Court of Appeals majority went on to express doubt as to SIPC's right to maintain a Section 17(a) claim on its own behalf, noting that "as the creature of a 1970 statute [the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78 aaa, *et seq.*], SIPC can hardly claim to have been a spe-

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* In No. 78-309, SIPC's co-respondent is Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc. (the "Trustee"). The Trustee is filing a separate cross-petition for certiorari.

** Reference herein to the opinions below will be to those opinions as printed in the Appendix to the Touche Ross' petition for certiorari in No. 78-309. Numerals followed by the letter "a" refer to pages in that Appendix.

cially protected beneficiary of the '34 Act''. In addition, Judge Mulligan in his dissent characterized the majority opinion as a holding that SIPC cannot bring a Section 17(a) action in its own right. Accordingly, should Touche Ross' petition for certiorari be granted, SIPC requests this Court to also grant this conditional cross-petition and thereby fully determine the capacity or capacities in which SIPC may or may not maintain a Section 17(a) claim.

The opinion of the Court of Appeals (1a-35a), rendered on April 21, 1978, is not yet officially reported but is unofficially reported at [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,404. The opinion of the District Court (40a-58a), which was reversed, is reported at 428 F. Supp. 483 (S.D.N.Y. 1977).

## Jurisdiction

The judgment of the Court of Appeals (36a-37a) was entered on April 21, 1978. On July 7, 1978, the Court of Appeals denied Touche Ross' petition for rehearing and suggestion for rehearing *en banc* (38a-39a). SIPC invokes the jurisditcion of this Court under 28 U.S.C. § 1254(1).

## Question Presented

May SIPC, the creature of a statute which by its terms is to be treated as if it constituted an amendment to and a part of the 1934 Act, maintain a right of action on its own behalf under Section 17(a) of the 1934 Act, which creates duties the violation of which causes direct harm to SIPC?

## Statutes and Rules Involved

Section 17(a) of the 1934 Act, Rule 17a-5 thereunder (17 C.F.R. § 240.17a-5), and Section 78bbb of SIPA all as in effect in 1972. Section 17(a) and Rule 17a-5 thereunder are set forth in the Appendix to Touche Ross' certiorari

petition in No. 78-309 (59a-70a). Section 78bbb of SIPA states that: "Except as otherwise provided in this Act, the provisions of [the 1934 Act] apply as if this Act constituted an amendment to, and was included as a section of, such Act".

## Statement of the Case

The facts herein and the proceedings below are adequately recited in Touche Ross' certiorari petition in No. 78-309 and in the briefs submitted by the respondents in opposition to that petition, including the Appendix to SIPC's brief in opposition wherein the complaint is reprinted. Those recitations are hereby incorporated by reference for the purposes of this conditional cross-petition for certiorari.

## The Reasons For Granting This Conditional Cross-Petition For Certiorari

In the interest of orderly judicial administration and in fairness to SIPC, the capacity or capacities in which it may or may not maintain a right of action under Section 17(a) should be determined at one time by this Court (see Point I, *infra*). Moreover, the erroneously narrow view taken by the court below of the relationship of SIPA to the 1934 Act ignores the fact that SIPC may itself be deemed a beneficiary of Section 17(a) (see Point II, *infra*). Accordingly, if Touche Ross' certiorari petition, which raises the issue of SIPC's right to maintain a Section 17(a) claim *qua subrogee,* is granted, this Court should likewise determine whether SIPC may assert a Section 17(a) claim *in its own right.*

## I. The Determination Of SIPC's Rights Under Section 17(a) Should Not Be Fragmented

In light of the interlocutory posture and the rare factual context of this case, whether SIPC may maintain a Section 17(a) claim in its own right is probably not an issue of

sufficient ripeness and of such general significance as to, in and of itself, merit consideration by this Court, just as the questions Touche Ross seeks to have this Court review are not worthy of this Court's attention (see pp. 10-14 of SIPC's brief in opposition to Touche Ross' petition for certiorari). However, if Touche Ross' petition for certiorari is granted, SIPC's conditional cross-petition should also be granted, in order to avoid confusion regarding, and possible piecemeal determinations of, the full extent of SIPC's rights of action under Section 17(a).

In the complaint, SIPC asserts its standing to sue Touche Ross under Section 17(a) *in two separate and distinct capacities:* (1) as the subrogee of such Weis customers whose liquidation claims have been satisfied through the depletion of the SIPC fund; and (2) as a direct beneficiary of Section 17(a) who may maintain a claim thereunder in its own right. As previously noted, the court below held that SIPC may sue in the first capacity; it did not reach the question of whether SIPC may sue in the second capacity (12a, n.13), although Judge Mulligan, in dissent, characterized the majority opinion as a holding that SIPC may not bring a Section 17(a) action in its own right (33a).

If Touche Ross' petition for certiorari is granted, SIPC should have a definitive and complete determination by this Court as to which of its claims are maintainable and which are not. Otherwise, the scope of SIPC's Section 17(a) rights in this action and elsewhere may be subject to confusion. For example, if the Touche Ross petition alone is granted and this Court subsequently affirms the Court of Appeals, would all of SIPC's claims herein remain viable? Similarly, if this Court grants Touche Ross' petition and rules in its favor, without considering whether SIPC's direct (as opposed to subrogation) claims are actionable, would SIPC still have a basis for proceeding in the District Court under its direct claims? In order to avoid such confusion, and in order to allow SIPC the opportunity to have its Section 17(a) rights fully determined by this Court at one time, this conditional cross-petition should be granted.

## II. The Court Below Failed To Properly Consider Whether SIPC Is A Beneficiary Of Section 17(a) In Its Own Right

The entire "analysis" by the court below of whether SIPC may maintain a right of action under Section 17(a) on its own behalf was confined to the following statement in footnote 13:

> "We need not reach the question whether SIPC could ever have a claim for damages other than on behalf of a broker's customers; we only note that as the creature of a 1970 statute, SIPC can hardly claim to have been a specially protected beneficiary of the '34 Act. SIPC makes much of 15 U.S.C. § 78bbb (1976), which treats SIPA as if it 'constituted an amendment to, and was included as a section of' the '34 Act. Nonethless, it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970; the cited portion of the 1970 statute appears to do no more than indicate that, except where specifically provided otherwise, any remedy created by SIPA is supplemental to the preexisting remedies of the '34 Act" (12a)

This cursory, oversimplified treatment of the issue, neither took into account the significant relationship between SIPC and Section 17(a), nor did it conform to the analysis required by *Cort* v. *Ash*, 422 U.S. 66, 78 (1975).

In the first place, SIPC is a quasi-governmental organization created by Congress to enhance the protection initially provided under Section 17(a) and Rule 17a-5 thereunder of the customers of broker-dealers. SIPC is a creature of SIPA, a statute which, as this Court has recognized, was enacted, *inter alia*, to "upgrade the financial responsibility requirements for registered brokers and dealers". *SIPC* v. *Barbour*, 421 U.S. 412, 415 (1975). Thus, SIPC shares a common purpose with Section 17(a)—

to protect investors insofar as they entrust their cash or securities to stock brokers.

Moreover, again as noted by this Court, the SEC has "plenary authority" to supervise SIPC's operations (*Id.* at 417). Because of this nexus between SIPC and the SEC, SIPC's assertion of a Section 17(a) claim in its own right goes beyond the ordinary "private" right of action. Indeed, the majority below was "materially aided" (3a, n.3; see also, 17a-19a) by the SEC's *amicus curiae* brief wherein the Commission unqualifiedly stated that "permitting a private right of action [for SIPC] under Section 17 of the Securities Exchange Act will provide a *necessary* supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder" (emphasis added). Thus, here as in *J.I. Case* v. *Borak*, 377 U.S. 426, 432 (1964), "[p]rivate enforcement provides a necessary supplement to Commission action." See also, *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25 (1977); *cf.*, the discussion in the majority decision below concerning the necessity of recognizing a right of action under Section 17(a) in favor of a broker's customers (10a-11a, see especially note 12).

In addition, a broker-dealer liquidation, such as the one Weis is currently undergoing, occurs at SIPC's behest and, to a large extent, at SIPC's expense. SIPC must, as it did in Weis' case, first seek and obtain a judicial decree that the broker's customers are in need of the protection afforded to them by SIPA. Thereafter, SIPC must make certain sums available to the Trustee for the satisfaction of claims filed by the liquidated broker's customers. To date, SIPC has made some fourteen million dollars available to the Trustee in the Weis liquidation.

The key to preventing such intervention by, and expense to, SIPC is the filing of accurate Section 17(a) reports. Those reports show whether a broker is in compliance with the net capital rule, which requires it to maintain a certain

ratio of liquid assets to aggregate indebtedness so that it may be able to promptly meet the demands of its customers at all times (8a-9a). If the Section 17(a) reports are materially false and misleading, as were the ones prepared by and containing the certification of Touche Ross, the purpose of the net capital rule is defeated, the broker's actual financial difficulty is masked, and the possibility of remedial action to save the broker is prevented. Because none of the regulatory authorities—and certainly not SIPC—independently verify the financial information contained in the Section 17(a) reports, the broker's accountant bears a heavy responsibility indeed in preparing, and making certifications as to, those reports. That responsibility extends to SIPC. As the court below noted:

> ". . . just as in *Borak* [377 U.S. 426 (1964)]—the SEC was not meant to, and does not have the resources to examine and audit all the documents that it receives (in *Borak*, proxy statements; here, section 17 reports). Both it and *SIPC, as well as the broker's customers must rely on the certification by the accountants.*" (10a, emphasis added)

Since the efficacy of the net capital rule and thus of Section 17(a) depends on the broker's accountant, the court below correctly held that Section 17(a) imposes a duty on accountants such as Touche Ross. SIPC has a right to enforce that duty on its own behalf because Touche Ross' violations of its Section 17(a) duties resulted in a direct and substantial harm to SIPC itself.

Indeed, the *Cort* v. *Ash* analysis which the court below failed to apply supports SIPC's right to invoke Section 17(a) on its own behalf. First, as previously explained, SIPC is a special beneficiary of Section 17(a); and, even though SIPC is the creature of a 1970 statute, that statute, by its own terms, is to be treated as "if it con-

stituted an amendment to, and was included as a section of, [the 1934 Act]" (SIPA Section 78bbb). Thus, as a creature of SIPA, SIPC may avail itself of the protection afforded by the 1934 Act to the same extent as if SIPC had existed in 1934. Certainly, unlike the plaintiff in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), SIPC is not a member of the class Congress intended to regulate. Instead SIPC may be deemed an *intended* beneficiary of Section 17(a) to the same extent as customers of broker-dealers. *Cf. SEC* v. *Packer, Wilbur & Co., Inc.*, 498 F.2d 978, 984-85 (2d Cir. 1974).

Second, the legislative history of Section 17(a) contains nothing expressing any Congressional intent to create or deny a private right of action thereunder. Congress simply did not consider the question, and, as this Court stated in *Cort* v. *Ash, supra* at 82, " . . . in situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling" (emphasis in original).

Third, SIPA obviously enhances the very purpose of Section 17(a), *viz.*, the protection of the customers of broker-dealers, and extends that protection to SIPC itself. Thus, the recognition that SIPC may maintain a Section 17(a) right of action on its own behalf would do no violence to the underlying purposes of the legislative scheme; indeed, such a recognition would be fully consonant with those purposes.

Finally, the statement of the court below with respect to the right of customers to invoke Section 17(a) is equally applicable to SIPC: ". . . it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' cus-

tomers varies widely. *There is no reason to believe that the remedy sought herein is one traditionally relegated to state law*" (emphasis added) (11a).

## CONCLUSION

**For the foregoing reasons, if this Court grants Touche Ross' petition for certiorari in No. 78-309, it should also grant this conditional cross-petition for certiorari.**

Respectfully submitted,

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## BRIEF OF RESPONDENT TOUCHE ROSS & CO. IN RESPONSE TO CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI

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## COUNTER-STATEMENT OF THE QUESTION PRESENTED

Is SIPC, an entity created by Congress in 1970 for purposes of providing to customers of securities brokerage firms increased financial protection, a beneficiary of the reporting requirements imposed by Section 17(a) of the Securities Exchange Act of 1934 such that SIPC may maintain in its own right an implied private right of action for violations of Section 17(a)?

## COUNTER-STATEMENT OF THE CASE

The relevant facts are set forth in Touche Ross' Petition in No. 78-309. With respect to the question presented by SIPC's conditional cross-petition, the District Court held that SIPC "could [not] possibly have been meant to be protected by Section 17" (54a). Both the Court of Appeals majority and the dissent agreed with that holding. The majority stated that "it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970" (12a [n.13]). Judge Mulligan, who dissented from the majority's holding that customers of a brokerage firm (and SIPC as their "subrogee") may assert an implied private right of action under Section 17(a), stated that

> "The majority has properly held that neither the trustee nor SIPC in its own right can bring any action under section 17(a) of the [19]34 Act. Neither can claim to be an intended beneficiary of that act since both are the creatures of SIPA, enacted in 1970. Nor is either appellant a public investor." (33a-34a)

## THE REASONS WHY TOUCHE ROSS DOES NOT OPPOSE SIPC'S CONDITIONAL CROSS-PETITION

Unlike the questions presented by Touche Ross' Petition in No. 78-309, the question presented by SIPC's conditional cross-petition is, as SIPC concedes, not "of

such significance as to, in and of itself, merit consideration by this Court" (Conditional Cross-Petition, p. 5). For the reasons stated in the decisions below, Touche Ross submits that SIPC's arguments on the merits of the question presented by the conditional cross-petition are completely erroneous. However, Touche Ross does not disagree with SIPC's contention that if this Court grants review with respect to the questions of Section 17(a) liability presented by Touche Ross in No. 78-309, this Court should have the opportunity to consider all questions necessary for "a definitive and complete determination" of whether any private right of action may be implied under Section 17(a) (Conditional Cross-Petition, p. 5). Therefore, without conceding the relevance or correctness of any of SIPC's contentions as to the merits, Touche Ross does not oppose SIPC's conditional cross-petition.

## CONCLUSION

For the foregoing reasons, Touche Ross does not oppose SIPC's conditional cross-petition for a writ of certiorari.

October 25, 1978.

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